In the Superior Court of Pennsylvania

No. 2324 EDA 2006

TRUST ESTATE OF EMANUEL ROSENFELD, SETTLOR.

Appeal of: LESTER ROSENFELD and ROBERT ROSENFELD.

BRIEF FOR APPELLANTS

On Appeal from the Adjudication and Decrees of the
Orphans' Court Division of the Court of Common Pleas
of Philadelphia County, O.C. No. 1664 IV of 2002

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Orphans' Court's Adjudication dated July 31, 2006 .... Attachment A

Orphans' Court's Decree dated August 1, 2006 .... Attachment B

Orphans' Court's Decree dated August 14, 2006 ....Attachment C

PLEASE NOTE: The Orphans' Court did not order appellants to file any Statement of Matters Complained of on Appeal pursuant to Pa. R. App. P. 1925(b), and therefore no such statement was filed.

I. STATEMENT OF JURISDICTION

On August 18, 2006, Lester Rosenfeld and Robert Rosenfeld filed their notice of appeal from the Orphans' Court Division of the Court of Common Pleas of Philadelphia County's Adjudication dated July 31, 2006 and Decrees dated August 1, 2006 and August 14, 2006. R.610a (notice of appeal). This Court possesses jurisdiction pursuant to Pennsylvania Rules of Appellate Procedure 341(a) ("an appeal may be taken as of right from any final order of a[ ] lower court") and 903(a) ("the notice of appeal required by Rule 902 * * * shall be filed within 30 days after the entry of the order from which the appeal is taken").

II. STATEMENT OF THE SCOPE AND STANDARDS OF REVIEW

Appellants Lester and Robert Rosenfeld principally argue on appeal that the Orphans' Court has committed various errors of law that require the reversal or vacation of the Adjudication and Decrees that are the subject of this appeal. This Court exercises *de novo* review of a trial court's rulings on questions of law. *See Buchleitner* v. *Perer*, 794 A.2d 366, 370 (Pa. Super. Ct. 2002) ("[u]pon appellate review, we are not bound by the trial court's conclusions of law, but may reach our own conclusions").

In particular, this Court exercises *de novo* review of the meaning of the three–page Irrevocable Trust agreement that created the Rosenfeld Trust. The Orphans' Court asserts that it based its ruling on the plain language of the Trust–creating document, and the Orphans' Court did not find that contract to be ambiguous so as to permit the consideration of extrinsic evidence. Accordingly, *de novo* review applies. *See Farmers Trust Co.* v. *Bashore*, 498 Pa. 146, 150, 445 A.2d 492, 494 (1982) ("A settlor's intent is to be

determined from all the language within the four corners of the trust instrument, the scheme of distribution and the circumstances surrounding the execution of the instrument."); *In re Ware*, 814 A.2d 725, 731–32 (Pa. Super. Ct. 2002) ("In order to determine the intent of the settlor of the trust, we look to the writing that established the trust, which is the best evidence of the settlor's intent.").

The Orphans' Court's decisions to remove Lester and Robert Rosenfeld as co–trustees of the Rosenfeld Trust and to tax Wachovia Bank's attorneys fees against them involved, in part, exercises of discretion, and thus an abuse of discretion standard of review applies to those rulings. *See In re Croessant's Estate*, 482 Pa. 188, 194, 393 A.2d 443, 446 (1978) (applying abuse of discretion standard to removal of a trustee); *Estate of Bruner*, 691 A.2d 530, 534 (Pa. Super. Ct. 1997) (reviewing an Orphans' Court's award of attorneys' fees under the abuse of discretion standard). As the Supreme Court of Pennsylvania has recognized, *see Rosenberg* v. *Silver*, 374 Pa. 74, 77, 97 A.2d 92, 94 (1953), an abuse of discretion exists by definition when a trial court's ruling is legally erroneous.

With regard to scope of review, the entire record developed during the account audit proceeding in the Orphans' Court is now before this Court for review, and this Court is entitled to draw upon that entire record in conducting appellate review.

III. TEXT OF THE ORDERS IN QUESTION

The Orphans' Court's Adjudication dated July 31, 2006 states, in pertinent part: "For this reason, Lester and Robert Rosenfeld should be surcharged in the joint amount of $593,546." Adjudication at 57.

The Orphans' Court's Decree dated August 1, 2006 states:

> AND NOW, this 1st Day of August 2006, upon consideration of the Account filed on March 31, 2004 by Co–trustee Wachovia Bank, the objections thereto by Co–trustee Rita Stein, the hearings held on January 25, 2005, January 26, 2005, January 28, 2005, February 2, 2005, May 3, 2005, May 4, 2005, the memoranda and supporting documentation, it is hereby ORDERED and DECREED that Lester Rosenfeld and Robert Rosenfeld are REMOVED as trustees of the Mary and Emanuel Rosenfeld Foundation for the reasons set forth in an Adjudication dated July 31, 2006.
>
> Exceptions to this decree may be filed within twenty (20) days. An appeal may be taken to the appropriate court within thirty (30) days.

Decree of Aug. 1, 2006.

And the Orphans' Court's Decree dated August 14, 2006 states:

> AND NOW, this 14th day of August, 2006, upon consideration of the Amended, Supplemental and Second Supplemental Petitions of Wachovia for Attorney Fees, the objections thereto, the hearing held on January 12, 2005, and the memoranda and supporting documentation submitted by Wachovia, it is hereby ORDERED AND DECREED that Wachovia's Amended, Supplemental and Second Supplemental Petitions are GRANTED and that Lester Rosenfeld and Robert Rosenfeld shall pay $425,506.54 to Wachovia as reimbursement for legal fees and costs incurred in defending itself against Plaintiff's claims, for the reasons set forth in an Adjudication dated July 31, 2006.

Decree of August 14, 2006.

IV. STATEMENT OF THE QUESTIONS PRESENTED

1. Did the co–trustees of the Rosenfeld Trust have a duty, either under the language of the Trust–creating document or under applicable law, to diversify the Trust's investments from the concentrated holdings in Pep Boys stock that the Trust's settlor contributed when founding the Trust in 1952?

2. Must the Orphans' Court's imposition of a surcharge be reversed, because the Trust did not sustain any financial loss as a result of Lester or Robert Rosenfeld's breach of any supposed duty to diversify the Trust's investments?

3. Did the Orphans' Court commit an error of law or otherwise abuse its discretion in removing Lester Rosenfeld and Robert Rosenfeld as co–trustees of the Rosenfeld Trust, because the removal decision was primarily based on that court's erroneous decisions that the Rosenfelds had breached a duty to the Trust and were liable for surcharge, because neither individual's actions endangered the trust, and because the Orphans' Court did not put the Rosenfelds on notice that the issue of their removal would be decided on the record of the account audit proceeding?

4. Did the Orphans' Court err or otherwise abuse its discretion in holding that Lester Rosenfeld and Robert Rosenfeld should reimburse Wachovia Bank for the attorneys' fees the Bank incurred in defending against co–trustee Rita Stein's legally unmeritorious breach of duty and surcharge claims, when the Rosenfelds were neither placed on notice that they could be found liable for those fees nor was the Rosenfelds' conduct in not agreeing to diversify the factual or legal cause of Mrs. Stein's assertion of unmeritorious claims against the Bank?

V. STATEMENT OF THE CASE

A. Relevant Factual History

On December 1, 1952, Emanuel Rosenfeld — one of the founding owners of the corporation known as The Pep Boys, Manny, Moe and Jack of California — executed a three–page Irrevocable Trust agreement creating a perpetual charitable trust known as the Mary and Emanuel Rosenfeld Foundation. R.1232a–34a (Ex. P–2). Emanuel Rosenfeld funded the Trust at its outset with 200 shares no par common stock of Pep Boys, then having a value of $15,000. R.1236a.

The Trust agreement named four trustees, three of whom were family members who agreed to serve without compensation and the fourth which was a bank with experience serving as a corporate trustee. R.1232a–34a. Named as individual trustees were Lester Rosenfeld, the son of Trust settlor Emanuel Rosenfeld; Rita E. Korn (now known as Rita Stein), the settlor's daughter; and Murray Rosenfeld, the settlor's brother. *Id.* The corporate trustee named in the document was Fidelity Philadelphia Trust Company, a bank that through mergers later became known as First Union and is now known as Wachovia Bank. *Id.* After Murray Rosenfeld died in August 1979, Robert Rosenfeld — the settlor's grandson and Lester Rosenfeld's son — replaced Murray as a co–trustee of the Rosenfeld Trust. Adjudication at 17.

The Irrevocable Trust document begins:

> The Trustees agree to hold the property received by them and such additional property as may be added hereto from time to time by the Settlor or others upon the following terms of trust:

R.1232a (Ex. P–2).

The first numbered paragraph of the Irrevocable Trust document instructs the trustees to use net investment income to make charitable contributions and specifies a number of Philadelphia area charities, predominately Jewish in affiliation, that should be considered as potential recipients of charitable contributions from the Trust. *Id.*

The second numbered paragraph of the Irrevocable Trust document begins by stating:

> (2) In addition to the powers given by law, the Trustees shall have and exercise the following powers as the decision of the majority of them may direct:
>
> (a) To retain any property delivered to them as long as in their discretion they deem it advisable to do so. For the exercise of this power, the Trustees are completely relieved from any responsibility by reason of any loss or shrinkage in value.

R.1233a.

For the first forty–five years following its creation in 1952, the Rosenfeld Trust's assets have consisted almost entirely of Pep Boys stock, with little to no diversification. And for nearly all of that period, none of the Trust's individual co–trustees, including Mrs. Stein, expressed any interest in diversification. The Trust's concentrated investment in Pep Boys proved quite beneficial. Over that period, the Trust's assets grew appreciably in value. In December 1952, Emanuel Rosenfeld funded the Trust at its outset with 200 shares of Pep Boys common stock, then having a value of $15,000. In October 1953, Emanuel Rosenfeld contributed another 250 shares of Pep Boys common stock worth $18,750. R.1582a (Ex. R–4). As of December 1953, the Rosenfeld Trust's assets were valued at $33,750. *See* Adjudication at 36.

By 1966, the Rosenfeld Trust's assets consisted of 18,375 shares of Pep Boys stock valued at $13 per share, for a total value of $238,875. R.1563a (Ex. R–2). As of April 2002, when Mrs. Stein commenced the litigation that gives rise to this appeal, the Rosenfeld Trust held 396,900 shares of Pep Boys stock worth $7,600,635. *Id.* As of the end of 2004, the account value of the Rosenfeld Trust was $8,303,453.80. *See* Adjudication at 36. This represents a 250–fold increase in the value of the assets of the Rosenfeld Trust from December 1953 through the end of 2004.

By contrast, the Standard & Poors 500 Index, between 1953 and 2004, grew 50–fold, meaning that the increase in the value of the assets of the Rosenfeld Trust from 1953 through 2004 was about five times as great as it would have been had the Rosenfeld Trust instead been invested in the more diversified, less volatile, S&P 500 Index during that same fifty–one year period. R.1133a–34a (T.T. 5/4/05 at pp. 44–45). Moreover, this comparison in value does not fully capture the outstanding performance of Pep Boys stock over the period in question, because it does not reflect that the Rosenfeld Trust made nearly $10 million in charitable contributions between 1966 and 2004 and additional substantial contributions between 1952 and 1966 for which records no longer exist due to a fire at the Bank. R.117a–292a; 1572a (First Account of Rosenfeld Trust; Ex. R–4).

Even though Pep Boys common stock has outperformed the S&P 500's average return by many multiples from 1953 to 2003, there have, of course, been times during that fifty–year period when Pep Boys performed worse than stock market indices. Pep Boys stock has always been volatile and has had numerous substantial price declines.

Over a six–month period from July 1990 to January 1991, the stock's price declined by over forty–five percent. And during a single month in late 1987, the stock's value declined by more than forty percent. If only those downturns could have been avoided — say, by using a crystal ball to enable one to sell Pep Boys stock before a decline in its value occurred and then repurchasing Pep Boys stock after the decline had reached bottom, in order to capture only the increases in that stock's value — the performance of the Rosenfeld Trust's investment portfolio would have been even more remarkable than it actually has been.

In recent years, Pep Boys stock has regularly outperformed various stock market indices that provided investors with greater diversification and less volatility. For example, from January 2000 through January 2005, the value of Pep Boys stock doubled, while the value of the Nasdaq Index dropped by approximately fifty percent. And from January 2001 to January 2005, the price of Pep Boys stock went up between three hundred and four hundred percent, while the S&P 500 Index declined slightly.

It was an interim decline in the value of Pep Boys stock that led co–trustee Rita Stein to initiate the litigation that gives rise to this appeal. The evidence shows that Mrs. Stein has been using much of her annual share of the money available for donation from the Rosenfeld Trust to pay pledges that she has made to various arts–related entities in south Florida. R.1596a; 807a–08a (Ex R–7; T.T. 1/27/05 at pp. 89–95).

In 2001, Mrs. Stein's share of the proceeds available from the Rosenfeld Trust for donation to charities proved insufficient to cover certain pledges she had previously made. R.28a (Complaint ¶37). That led Mrs. Stein to ask her co–trustees if she could

have one–half of the money available for donations from the Rosenfeld Trust, instead of her usual one–third, to give to the charities of her choice. R.745a (T.T. 1/26/05 at p. 95). The other trustees did not accede to her request. *Id.*

Mrs. Stein retaliated by suing her brother Lester, her nephew Robert, and corporate trustee First Union for supposedly having breached their fiduciary duty to the Rosenfeld Trust by failing to agree to diversify the Trust's assets away from a concentration in Pep Boys stock. Had such a negligent failure to diversify not occurred, Mrs. Stein contended, the value of the Rosenfeld Trust would have been even greater than what it was. R.28a (Complaint ¶35). According to Mrs. Stein's testimony at the hearings in this case, she had not pressed the issue of diversifying the Rosenfeld Trust's investments until sometime in 1997, more than forty–four years after she became a co–trustee. R.805a (T.T. 1/27/05 at p.81).

On September 30, 1997, when Pep Boys common stock was trading at a historically high price, First Union dispatched a letter to Lester Rosenfeld, with copies to the other individual co–trustees, discussing the possible diversification of the Trust's investments. The letter stated:

> Dear Mr. Rosenfeld:
>
> Due to the difficulty of scheduling a meeting of the co–trustee's [sic] of the Rosenfeld Foundation, I would like to take this occasion to further the discussion of diversifying the above referenced portfolio. In support of this discussion, I have provided a review of the Rosenfeld Foundation performance as well as a booklet reviewing asset allocation.
>
> I would like to focus your attention on the following areas:

While acknowledging the wealth created by Pep Boys Stock, it is important to recognize the poor performance of the stock in recent years relative to the market. (See Rosenfeld Foundation Book Tab III) The equity component of the portfolio has returned 2.90% annualized over the past three years ending June 30, 1997 versus 28.86 % for the S&P 500.

First Union, in its fiduciary role, believes in the tenants [sic] of modern portfolio theory and strongly recommends a greater diversification of the portfolio. This would serve to reduce the volatility of the portfolio as well as to protect the trustee against potential liability resulting from a concentration in a limited number of securities.

In order to facilitate this diversification, we recommend reducing Pep Boys Stock to less than 10% of the equity portion of the portfolio within two years, potentially taking advantage of any strength in the stock price of Pep Boys to accelerate this process. In any event, there should be a regular program of divestment.

As to the investment of the proceeds, a contemporary asset allocation for a foundation of this size and sophistication might resemble the following:

	40%	Large Cap Blend
	15%	Mid/Small Cap
	10%	International Equity
Equity	65%	
Fixed Income	35%	
Total	100%	

While we would recommend using funds to meet this allocation and gain diversification, the large capitalized portion of the equity portfolio as well as the bond portion may be individually managed if you so desire.

I am sending to the other trustees the presentation material addressing asset allocation as well as the existing portfolio for their review.

I would welcome the opportunity to discuss these items in greater detail and address any questions or concerns that arise from you or any of the other trustee [sic] at your convenience.

In order to facilitate a timely discussion of these issues, either Judy Prendergast or myself will contact you in order to schedule a meeting or

> conference call. If you agree with these recommendations, kindly indicate your approval by adding your signature to the enclosed copy of this letter and return in the envelope provided.
>
> As always, if you should have any questions or require any further assistance, do not hesitate to contact me at (215) 985–####.
>
> Sincerely,
>
> Eric M. Wiegand
> Senior Vice President

R.1327a–30a (Ex. P–34).

The Bank's letter acknowledges the wealth created by Pep Boys stock while recommending greater diversification to reduce volatility in the Trust's portfolio. There is no contention that the Pep Boys investment had somehow become imprudent. The letter makes no reference to the Trust instrument and contains no notification to the co–trustees of a fiduciary duty to divest Pep Boys stock or to diversify the Trust's holdings. The letter does not make any prediction about the future performance of Pep Boys stock but does mention an expectation of future strength in the price of the stock. Although the letter contains a hypothetical allocation among classes of investments, it makes no specific proposal for reinvesting the proceeds from any actual sales of Pep Boys stock, nor does the letter recommend a date when the actual sale of Pep Boys stock should begin. The letter also fails to state whether Mrs. Stein was in favor of diversification and, if so, the period for diversification that she favored or the reinvestment strategy that she favored.

The foregoing letter was apparently mailed to its recipients, as the letter itself contains no mention of any expedited form of delivery. Although the letter stated that

someone from First Union would follow–up the letter by trying to schedule an in–person meeting or a conference call to discuss the issues raised in the letter, there was no evidence introduced at the hearing that any such follow–up from First Union occurred until over one year later.

On October 6, 1998, First Union sent a letter to the co–trustees confirming a conference call scheduled for October 16, 1998 to discuss the concept of diversification. R.1366a (Ex. P–48). During that conference call, Lester Rosenfeld and Robert Rosenfeld did not support the investment vehicles that First Union had proposed. R.883a (T.T. 1/28/05 at p.153). And on October 22, 1998, First Union sent a letter to the co–trustees that was nearly identical to First Union's letter of September 30, 1997. R.1331a–32a (Ex. P–38).

Nearly five months later, on March 17, 1999, First Union sent a letter to the co–trustees asking the co–trustees to execute the attached letters by means of which the co–trustees would have agreed to indemnify First Union for any loss in value to the Rosenfeld Trust due to the trustees' failure to agree to diversification. R.1306a–09a (Ex. P–29). None of the individual co–trustees, not even Mrs. Stein, signed and returned the indemnification document that First Union had solicited.

Finally, on December 13, 1999, First Union sent a letter to its co–trustees stating that a deadlock on the question of diversification existed and that, in First Union's view, "it is clearly imprudent as trustees to hold only a single stock as the entire portfolio of the Foundation." R.1253a (Ex. P–12). In response, both Lester and Robert Rosenfeld told

First Union that they did not believe it was prudent to diversify from Pep Boys stock at that time and price. R.1256a; 1363a (Exs. P–13; P–41).

Lester Rosenfeld, the son of settlor Emanuel Rosenfeld, spent his entire life working for the Pep Boys Company that his father founded. *See* Adjudication at 6. He started at the very bottom of the warehouse, then moved to stores, and eventually worked as an understudy to his father. *Id.* Lester rose to a Vice President at the company and was involved in real estate and security transactions. *Id.* He retired from the company in 1980, but continued to serve as a consultant for some time thereafter. *Id.* He served on the Board of Directors of Pep Boys from 1952 until he reached the mandatory retirement age. *Id.* For a period thereafter, he was still able to attend board meeting as an emeritus without the power to vote, but now he no longer attends those meetings. *Id.*; R620a (Petition to Stay Removal at 7). Lester's investment philosophy, as expressed during his testimony in the Orphans' Court hearings, is that it is better to invest in companies that you know the most about than to pursue diversification just for the sake of avoiding concentration and volatility. R.761a (T.T. 1/26/2005 at p. 158–59).

Robert Rosenfeld is the son of Lester and the grandson of the settlor, Emanuel Rosenfeld. He testified that he was unaware between 1997 and 1999 of Mrs. Stein's desire for diversification and that he did not become aware of the issue until December 1999, when First Union sent a letter suggesting that the Bank would take legal action to force the issue of diversification. R.904a (T.T. 2/2/05 at 53–54). He responded in late 1999 by writing a reply to First Union stating that "I am not opposed to diversifying the

portfolio, although at Pep Boys current price, I would be against the timing." R.1256a (Ex. P–13). Robert also testified that he felt comfortable relying on his father's view concerning whether Pep Boys remained a good investment for the Trust, because Lester Rosenfeld had intimate knowledge of that company. R.904a–05a (T.T. 2/2/05 at pp.56–57).

During the hearings, Mrs. Stein also presented testimony from First Union's portfolio manager, who related that during the year 2000 Robert Rosenfeld had expressed an additional reason why he opposed diversification: because he was then concerned that going against his father's wishes on that issue would lead him to be disinherited. R.732a (T.T. 1/26/05 at pp. 43–44). The portfolio manager further testified that Robert also opposed diversifying in 2000 due to his concern about the price of the stock. R.734a (*id.* at 50). At the time of the liability hearing in this case, Lester and Robert Rosenfeld were not communicating with each other. *See* Adjudication at 58.

More recently, however, Lester and Robert Rosenfeld have reconciled their differences and now regularly communicate with each other. R.618a (Petition to Stay Removal at 5). Moreover, before the Orphans' Court issued its Adjudication in late July 2006, the co–trustees have continued to authorize further diversification, so that approximately half of the Rosenfeld Trust's assets were no longer held in Pep Boys stock. *Id.* And in May 2005, Lester Rosenfeld, Robert Rosenfeld, and Wachovia voted to reinvest the proceeds of the sale of Pep Boys stock in a broadly–based portfolio of exchange traded funds. *Id.*

B. Relevant Procedural History

In April 2002, Mrs. Stein commenced this litigation in the Civil Trial Division of the Court of Common Pleas of Philadelphia County. *See* Adjudication at 2. She named as defendants the other three co–trustees of the Rosenfeld Trust: First Union Bank (now known as Wachovia Bank); Lester Rosenfeld; and Robert Rosenfeld. Mrs. Stein asserted a claim for alleged reputational damages as a result of not having sufficient funds from the Trust to satisfy her personal charitable pledges. *Id.* In addition, she sought to have the other trustees held liable in damages for the supposed losses to the Rosenfeld Trust due to its concentration in Pep Boys stock and to have the Trust partitioned. *Id.* at 3.

The Civil Trial Division, in September 2002, transferred Mrs. Stein's lawsuit to the Orphans' Court Division except for her claim alleging reputation damages, which remained in the Civil Trial Division. *Id.* at 2. All three defendants moved for dismissal of the claim for reputational damages, and Judge Watkins dismissed that claim on summary judgment in September 2003. *Id.*

Meanwhile, the Orphans' Court ordered that Mrs. Stein's claims alleging that her co–trustees breached their fiduciary duties and therefore should be surcharged and Mrs. Stein's request to partition the Trust would be adjudicated in connection with the audit of the First Account of the Rosenfeld Trust that Wachovia Bank had filed and Mrs. Stein's objections thereto. *Id.* at 5; R.294a–95a (Mrs. Stein's Objections to Accounting).

In January 2004, Wachovia moved for summary judgment in the Orphans' Court on Mrs. Stein's remaining claims against the Bank. Wachovia's summary judgment papers argued that there was no duty under either the law or the Trust–creating

document to diversify, and that, to the contrary, the Trust–creating document explicitly expressed a preference for retaining the Trust's concentration in Pep Boys stock and made it particularly difficult for the co–trustees to override that preference. R.61a–63a (Wachovia's s.j. brief at 6–8). Wachovia also argued that the Trust had suffered no loss due to the failure to diversify, that on the contrary the failure to diversify was extraordinarily beneficial to the Trust's overall appreciation in value, and that any short–term "paper losses" or relative lag in performance did not give rise to surcharge liability. R.64a–66a (*id.* at 9–11).

On May 19, 2004, the Orphans' Court granted Wachovia's motion for summary judgment dismissing all claims that sought relief against the Bank. In granting Wachovia's motion for summary judgment, the Orphans' Court wrote:

> Ms. Stein's father, as settlor, certainly knew that in designating an even number of trustees, a deadlock or tie vote was a distinct possibility. Not only did he provide no mechanism to break such a tie vote, but he also expressly included a proviso that certain actions could only be taken by a majority vote. The trust instrument read as a whole, therefore, clearly evidences the settlor's intent to allow no action to occur in tie vote or deadlock situations. Thus, the settlor's intent was to condition affirmative action of the trustees on a 3 to 1 or unanimous vote. In addition, the individual and corporate trustees were given an equal standing with each other.
>
> Moreover, the Rosenfeld trust agreement does not explicitly require the diversification of the sole assets by which it was funded—the Pep Boys stock—but instead gave a majority of the trustees discretion to retain the stock as long as they thought advisable. Thus, the Rosenfeld trust agreement provides that the "trustees agree to hold the property received by them and such additional property as may added hereto from time to time by the Settlor or others." Significantly, the Rosenfeld trust agreement contains an indemnity provision that specifically addresses any decision by the trustees to retain property of the trust:

> (2) In addition to the powers given by law, the Trustees shall have and exercise the following powers as the decision of the majority of them may direct:
>
> (a) To retain any property delivered to them as long as in their discretion they deem it advisable to do so. For the exercise of this power the Trustees are completely relieved from any responsibility by reason of any loss or shrinkage in value.
>
> Rosenfeld Trust Agreement, Paragraph (2)(a)
>
> By its clear terms, this indemnity provision gives the Trustees—as a majority—the discretion to retain any property as long as they deem it advisable to do so. The problem is that the agreement makes no provision for action as to retention of property delivered to them by less than a majority of the trustees nor does it provide a method for breaking a deadlock.

Rosenfeld Trust, 25 Fiduciary Rptr. 2d 165, 171 (Phila. Cty. O.C. 2004).

Later in that opinion, the Orphans' Court noted its agreement with Wachovia's argument that "neither Pennsylvania law nor the trust agreement set forth an absolute requirement for diversification." *Id.* at 173. And slightly later in that opinion, the Orphans' Court observed:

> the terms of the trust required a majority decision as to the retention of assets; it provided no means to break the deadlock; and further, it immunized the trustees for any liability due to the loss in value of assets due to a retention decision.

Id. at 174. In the final analysis, the Orphans' Court concluded that because "the corporate trustee did not breach its fiduciary duty nor act negligently in its administration of the foundation assets, there is no basis for a surcharge against Wachovia." *Id.* at 175 (footnote omitted). Based on that ruling, the Orphans' Court

concluded that it was unnecessary to address Wachovia's argument that the Trust has not suffered any loss. *Id.* at 175.

After denying the Rosenfelds' motion for summary judgment, the Orphans' Court permitted Mrs. Stein's claims alleging breach of fiduciary duty and negligence, and seeking a surcharge, to proceed against Lester and Robert Rosenfeld, along with Mrs. Stein's claim seeking to partition the Trust. The Orphans' Court set the matter down for a hearing to begin in late January 2005, and, over the objection of the Rosenfelds, the Orphans' Court decided to bifurcate the question of liability from the question of damages.

At the conclusion of five days of hearings on the issue of liability, the trial court stated after argument on the Rosenfelds' counsel's motion for judgment that "I believe that the evidence is of a clear and convincing nature that there is a breach of fiduciary duty on the part of Lester Rosenfeld and Robert Rosenfeld." R.929a (T.T. 2/2/05 at p. 154, lines 2–6). And on the record the Orphans' Court judge identified the duties breached as "[p]rudent investment advice and decision–making." R.929a (*id.* at p. 155, lines 4–5).

The proceedings then adjourned for three months, during which Mrs. Stein and the Rosenfelds prepared to present evidence relating to the question of damages. At the outset of the first day of the damages hearing, on May 3, 2005, counsel for the Rosenfelds presented and thereafter argued a motion *in limine* to preclude the testimony of Mrs. Stein's proposed damages expert, Craig J. McCann, Ph.D. The motion *in limine* to preclude Dr. McCann's testimony pointed out that Dr. McCann's damages

calculation should be excluded because it deviated from the liability evidence in numerous, significant respects, including: Dr. McCann calculated damages based on a breach of duty date that was far earlier than the evidence supported; Dr. McCann's timetable for diversification was much more rapid than the evidence supported; and Dr. McCann's hypothetical diversified portfolio was, by Dr. McCann's own admission, not based on any evidence in the record. Instead of being based on the evidence of record, Dr. McCann admitted that his hypothetical diversified portfolio was based on his own view concerning what investments were optimal for a diversified portfolio. R.590a (Rosenfelds' motion *in limine* regarding Dr. McCann).

After hearing Dr. McCann's testimony and entertaining argument on the motion *in limine*, the Orphans' Court denied that motion. R.1116a (T.T. 5/4/05 at p. 27). The Rosenfelds presented as their expert witness at the damages phase of the proceedings Andrew W. Postlewaite, Ph.D. Dr. Postlewaite testified:

> My opinion is that there were not sufficient information in the record for an expert to be able to calculate damages with a reasonable degree of accuracy.
>
> * * *
>
> The main problem was that there was nothing in the record that I saw that resembled a specific plan for diversification. There were various places where there were informal suggestions, but there were no — there was no place where there was a proposal to sell stock at a particular time or at a particular price. And there was no real suggestion of a plan as to what the alternative investment would be.

R.1129a–30a (T.T. May 4, 2005, at p. 40, line 25 to page 41, line 19).

Dr. Postlewaite also testified in accordance with a schedule of calculations presented in his follow–up report. To arrive at those calculations, Dr. Postlewaite took the investment vehicles that Dr. McCann used as representing a diversified portfolio (while recognizing that Dr. McCann's portfolio had no basis in the evidence), extended the time for diversification to the full two–year period that First Union had alluded to in its September 30, 1997 letter, and then calculated how the Trust performed as compared to Dr. McCann's hypothetical portfolio in a timeframe that was more closely linked to the evidence introduced during the liability phase of the hearings. R.1136a–37a (T.T. 5/4/05 at pp. 47–48).

What Dr. Postlewaite's calculations revealed was that only if the Rosenfelds were found to have breached their fiduciary duty to diversify on September 30, 1997 — the very date on which First Union sent its initial letter raising the possibility of diversification — would Dr. McCann's approach produce damages, in the amount of $593,546. R.1622a (Ex. R–15). In other words, only if Lester and Robert Rosenfeld were at fault for failing to agree to diversify as of the earliest moment that First Union mailed a letter seeking to initiate a conversation on the subject would any surcharge against them be supported using Dr. McCann's proposed diversified portfolio.

Dr. Postlewaite's chart further demonstrated that if the Rosenfelds' supposed breach of duty occurred on November 30, 1997, two months after First Union's letter, the Trust *would actually have lost money* by December 30, 2003 as a result of having begun diversification away from Pep Boys stock as of November 30, 1997. *Id.* And Dr. Postlewaite's chart further revealed that had the Rosenfelds' supposed breach of duty

arisen either March 30, 1998 or September 30, 1998, the Trust *would have suffered even more significant losses* as a result of not having remained wholly invested in Pep Boys stock — losses totaling $1.4 million and $3.4 million respectively. *Id.* It is noteworthy that First Union did not believe a stalemate on the question of whether to diversify existed until sometime in 1998 (R.1564a; 743a (Ex. R–2; T.T. 1/26/05 at p. 88)), and so even if that stalemate constituted the Rosenfelds' breach of their fiduciary duty — a point that the Rosenfelds dispute, as argued below — the stalemate caused the value of the Trust to be worth $3.4 million *more* than had the stalemate not occurred.

Dr. Postlewaite also testified that the hypothetical diversified portfolio used in Dr. McCann's proposed damages calculation provided an average return of eight percent per year from 1952 through 2004, and thus if the Rosenfeld Trust's investments had been diversified from its outset using Dr. McCann's hypothetical portfolio, the value of the Rosenfeld Trust after making five percent charitable contributions each year (as required under IRS regulations) would have been merely $150,000, providing only the capacity to make charitable contributions of $7,000 to $8,000 per year, instead of the Trust's actual value of $8.3 million, producing a contribution capacity per year of $400,000 to $500,000. R.1148a–49a (T.T. May 4, 2005 at page 59, line 17 to page 60, line 21).

On July 31, 2006, one year and two months after the conclusion of the two–day damages phase of the hearings, the Orphans' Court issued a seventy–nine–page Adjudication. The Orphans' Court ruled that under the language of the Trust–creating document, the Rosenfelds had a duty to diversify the Trust's investments from the

concentrated holdings in Pep Boys stock that the Trust's settlor had originally contributed. *See* Adjudication at 22–26.

The Adjudication agreed with the Rosenfelds' argument, in their motion *in limine*, that Mrs. Stein's damages expert witness, Dr. McCann, did not base his damages calculations on the evidence that the Orphans' Court had relied on in finding that the Rosenfelds had breached their fiduciary duty. *See* Adjudication at 44, 50–51. But, instead of rejecting Mrs. Stein's surcharge claim based on her failure of proof as to damages, the Orphans' Court instead fixed the date of the Rosenfelds' breach of duty at September 30, 1997, the only date on which the calculations performed by defendants' expert, Dr. Postlewaite, showed a "loss" as having resulted to the Trust due to a failure to diversify. *See* Adjudication at 44; R.1622a (Ex. R–15). And, based on the calculations of the Rosenfelds' own expert witness, Dr. Postlewaite, the Orphans' Court ruled that the Rosenfelds were jointly liable to pay a surcharge in the amount of $593,546. *See* Adjudication at 57.

In the context of considering Mrs. Stein's claim for partition of the Trust, and under the mistaken belief that the proceeds of the Trust's recent sale of Pep Boys stock remained in cash due to an impasse on how to reinvest those proceeds that had in fact already ended, the Orphans' Court's decision unexpectedly shifted to adjudicate whether Lester and Robert Rosenfeld should be removed from service as co–trustees. *Id.* at 57–61. Although Mrs. Stein's original civil action complaint had contained a count for removal, that issue was neither preserved by Mrs. Stein nor litigated during the hearings that the Orphans' Court conducted on the surcharge and partition issues, and

accordingly the Rosenfelds were not on notice that the Orphans' Court was planning to decide the question of removal as a part of its ruling on the surcharge issue. R.294a–95a (Mrs. Stein's Objections to Account). Moreover, the Orphans' Court had received during the hearings no expert or lay testimony that focused directly on the issue of removal.

Because the Rosenfelds were not on notice that a decision on the issue of removal was impending, they were unaware of any need to draw to the Orphans' Court's attention specifically in connection with the issue of removal that various facts relevant to the issue of removal had changed during the fourteen months between the end of the hearings and the issuance of the Adjudication. The two most important facts that had changed were that the proceeds from the sale of Pep Boys stock had been reinvested in a broadly diversified portfolio of exchange–traded funds, and Lester and Robert Rosenfeld had reconciled and were once again regularly communicating with one another. R.618a (Petition to Stay Removal at 5).

The Adjudication also contained one final surprise for the Rosenfelds, in connection with Wachovia's application to recover payment of the counsel fees it incurred in defending against Mrs. Stein's unmeritorious claims. The Orphans' Court ruled, once again with no notice to the Rosenfelds and, in this instance, at the suggestion of none of the parties, that Wachovia's attorneys' fees should be taxed against the Rosenfelds because it was their conduct that caused Mrs. Stein to initiate this litigation. *See* Adjudication at 61–78. The Orphans' Court also failed to hold a hearing on Wachovia's second supplemental motion for attorneys' fees. *Id.* at 73–74. Therein,

Wachovia sought to recover among other things the attorneys' fees and costs that the Bank incurred in seeking to recover its attorneys' fees from the Orphans' Court at the earlier attorneys' fee hearing. *Id.* Although the Rosenfelds were not the parties from whom Wachovia had sought to recover payment of its fee requests, the Rosenfelds did file an objection to the Bank's second supplemental fee request, arguing that the request was too high in various respects and that significant portions should be assessed against Mrs. Stein rather than the Trust. R.532a–36a (Rosenfelds' objections to fee petition).

On August 18, 2006, Lester Rosenfeld and Robert Rosenfeld filed a timely appeal to this Court from the Orphans' Court's Adjudication dated July 31, 2006, the Orphans' Court's Decree dated August 1, 2006 removing them as co–trustees, and the Orphans' Court's Decree dated August 14, 2006 granting Wachovia's petition for attorneys' fees and taxing those fees against the Rosenfelds. R.610a (notice of appeal)

VI. SUMMARY OF THE ARGUMENT

The Orphans' Court held in this case that Lester and Robert Rosenfeld on September 30, 1997 breached their duty as trustees of the Rosenfeld Trust by failing to diversify the investment portfolio of that charitable Trust away from its historic concentration in Pep Boys stock. The settlor, Emanuel Rosenfeld, created the Rosenfeld Trust in 1952 and endowed it solely with stock in Pep Boys, the company that the settlor founded and led to great success.

As explained below, there are three circumstances when a trustee has a duty to diversify the holdings of a trust concentrated in a single investment. The first is if the law mandates such diversification. It is undisputed here that neither statutory law nor

case law required the trustees of the Rosenfeld Trust, created in 1952, to diversify its investments.

A second circumstance is if the trust's concentration in a single investment threatens the principal of the trust, defined as the value of the assets originally used to create the trust, or if the trust's concentration in a single investment is unambiguously incompatible with the trust's purpose. Here, the Rosenfeld Trust's concentration in Pep Boys stock never threatened the Trust's principal, nor was that investment ever unambiguously incompatible with the Trust's purpose.

Third and finally, a trust's concentration in a single investment should be eliminated if that is what the settlor commanded in the trust–creating document. The Orphans' Court ruled that the Rosenfelds violated this third duty, holding that the document creating the Rosenfeld Trust required diversification in 1997 after permitting the Trust's concentration in Pep Boys stock to persist since 1952. The breach occurred, according to the Orphans' Court, when a First Union investment officer sent a letter to co–trustee Lester Rosenfeld recommending some diversification of the Trust's investments. Yet the Trust instrument entirely fails to support the Orphans' Court's holding that the instrument gave rise to a duty to diversify. Indeed, none of the parties to this vociferously litigated matter ever argued that such a duty arose under the Trust instrument. Accordingly, the Orphans' Court's invention of a duty that the Rosenfelds supposedly breached in failing to agree to diversify requires reversal.

The Orphans' Court's imposition of a surcharge against the Rosenfelds also must be reversed because, even if they breached some supposed duty to diversify the Trust's

investments, there is no basis in the record for calculating damages or for concluding that the Rosenfelds' breach of duty damaged the Trust. In the absence of loss there can be no surcharge, and therefore the Orphans' Court's surcharge must be reversed.

The Orphans' Court's Decree removing the Rosenfelds as co–trustees also must be reversed. The removal decision was primarily based on that court's erroneous decisions that the Rosenfelds had breached a duty to the Trust and were liable for surcharge. Moreover, the Rosenfelds' actions did not endanger the trust. And the Orphans' Court failed to put the Rosenfelds on notice that the issue of their removal would be decided on the record of the account audit proceeding.

Finally, the Orphans' Court's decree assessing Wachovia Bank's attorneys' fees against the Rosenfelds must be reversed. The Orphans' Court ruled that Lester and Robert Rosenfeld should reimburse Wachovia Bank for the attorneys' fees the Bank incurred in prevailing against co–trustee Rita Stein's legally unmeritorious breach of duty and surcharge claims against the Bank. Yet the Rosenfelds were neither placed on notice that they could be found liable for those fees nor were the Rosenfelds the factual or legal cause of Mrs. Stein's assertion of unmeritorious claims against the Bank. And the Bank's fee request includes a claim for so–called "fees on fees" that did not result from work whose purpose was to benefit the Trust estate.

VII. ARGUMENT

A. The Orphans' Court Erred In Holding That Either The Trust–Creating Document Or Applicable Law Imposed A Duty On Trustees To Diversify The Trust's Investments From The Concentrated Holding In Pep Boys That The Settlor Created

1. The Trust–creating document imposed no duty on the Trustees to diversify the Trust's investments

The Orphans' Court ruled that by refusing to agree to diversify the holdings of the Rosenfeld Trust in September 1997, Lester and Robert Rosenfeld were in violation of the terms and dictates reflected in the Trust–creating document that Emanuel Rosenfeld had executed in December 1952. Yet a review of the Orphans' Court's rationale along with the plain language of the Trust–creating document reveals that the Orphans' Court's holding is unsupported by the Trust–creating document's plain language and the intent expressed therein.

The Orphans' Court's Adjudication concludes that the document Emanuel Rosenfeld executed to create the Irrevocable Trust "envisioned a concerted consideration of retention of trust property so that a majority consensus might be achieved as to the advisability of retaining stock." Adjudication at 38. Earlier in its opinion, the Orphans' Court wrote that "[t]he settlor thus had devised a delicate balance in which the determination of retention of assets hinged on majority consideration of the advisability of such retention." *Id.* at 31. A few pages earlier, the Orphans' Court wrote that "a decision [to retain Pep Boys stock] was to be made by a majority of the trustees. Moreover, the trustees had to consider the advisability of such retention." *Id.* at 27. And a few pages later in that very same opinion, the court asserts

that the Rosenfelds "overlook the language and intent of the trust document requiring the majority of trustees to consider the advisability of stock retention." *Id.* at 35. Finally, when the Orphans' Court's opinion turns to the subject of damages, the opinion describes the case as one in which "two trustees breached their duty in failing to rectify a fund overly concentrated with highly volatile stock once they were confronted on this issue by their co–trustees." *Id.* at 42.

The language of the document that Emanuel Rosenfeld used to create the Rosenfeld Trust does not impose the duty the Orphans' Court has perceived. To begin with, the Supreme Court of Pennsylvania has instructed that in construing a trust instrument, "it is basic that it must be read as a whole and every portion thereof considered in determining its intent and true purpose." *In re Alloy Mnfg. Co. Employees Trust*, 411 Pa. 492, 495–96, 192 A.2d 394, 396 (1963). More recently, in *Estate of Niessen*, 489 Pa. 135, 138, 413 A.2d 1050, 1052 (1980), the Supreme Court of Pennsylvania recognized the "equally important precept in our law that where a trust instrument is explicit as to the duty owed, it, as evidencing the settlor's (testator's) intent, should govern."

In *Appeal of Trustee Sky Trust*, 868 A.2d 464 (Pa. Super. Ct. 2005), this Court explained:

> [C]ourts cannot rewrite a settlor's deed of trust or distort his language or the language of a statute in order to attain what is believed to be beneficial or wise or even what it is believed that the settlor would or should have provided if he or she possessed a knowledge of all presently existing circumstances. To ascertain the actual intent of the settlor or testator, a court must place itself in his or her armchair and consider not only the

> language and scheme of the instrument but also the facts and circumstances with which the settlor was surrounded.

Id. at 488 (internal quotations, citation, and brackets omitted).

The standard of care applicable to non–corporate trustees such as Lester and Robert Rosenfeld has been described by the Supreme Court of Pennsylvania as "the skill and judgment which a prudent person, under similar circumstances, would exercise in connection with the management of his or her own estate." *In re Mendenhall*, 484 Pa. 77, 80, 398 A.2d 951, 953 (1979).

A duty to diversify from the Rosenfeld Trust's original concentration in Pep Boys stock that the settlor created in 1952 is nowhere to be found in the Trust–creating document and thus would not be apparent to a trustee of reasonable prudence.

The third paragraph of the Irrevocable Trust document begins:

> The Trustees agree to hold the property received by them and such additional property as may be added hereto from time to time by the Settlor or others upon the following terms of trust:

R.1232a (Ex. P–2). Thus, from the outset of the Trust–creating document, the settlor has instructed the co–trustees to hold "the property" — namely, Pep Boys stock — that he was using to fund the Trust.

The second numbered paragraph of the Irrevocable Trust document begins by stating:

> (2) In addition to the powers given by law, the Trustees shall have and exercise the following powers as the decision of the majority of them may direct:
>
> (a) To retain any property delivered to them as long as in their discretion they deem it advisable to do so. For the exercise of

> this power, the Trustees are completely relieved from any responsibility by reason of any loss or shrinkage in value.

R.1233a (Ex. P–2).

As the Orphans' Court properly recognized in its earlier opinion granting Wachovia's summary judgment motion, the Trust–creating document through its language and effect created a situation whereby it was particularly difficult for the Trust to divest itself of a concentration in Pep Boys common stock. *Rosenfeld Trust*, 25 Fiduciary Rptr. 2d at 171. To begin with, the Trust was from the outset created and funded solely with Pep Boys common stock. The Trust–creating document expressly encourages the continued holding of Pep Boys common stock in at least two key respects: (1) by requiring that a majority of at least three of the four co–trustees agree to sell the stock in order to invest in other assets; and (2) by explicitly providing indemnification to the co–trustees for the continued holding of Pep Boys stock if a majority votes to retain that stock.

Although the indemnification language of the Trust–creating document is not directly implicated here, because a majority of the co–trustees did not agree to continue to hold Pep Boys stock during the period on which Mrs. Stein's lawsuit focuses, that aspect of the Trust–creating document can only be understood as Emanuel Rosenfeld's expression of a preference that the foundation he created, as one of the founders of the Pep Boys company, would continue to remain concentrated in Pep Boys stock into the future.

According to the Orphans' Court's earlier opinion granting Wachovia's motion for summary judgment:

> Ms. Stein's father, as settlor, certainly knew that in designating an even number of trustees, a deadlock or tie vote was a distinct possibility. Not only did he provide no mechanism to break such a tie vote, but he also expressly included a proviso that certain actions could only be taken by a majority vote. The trust instrument read as a whole, therefore, clearly evidences the settlor's intent to allow no action to occur in tie vote or deadlock situations. Thus, the settlor's intent was to condition affirmative action of the trustees on a 3 to 1 or unanimous vote. In addition, the individual and corporate trustees were given an equal standing with each other.

Rosenfeld Trust, 25 Fiduciary Rptr. 2d at 171.

Emanuel Rosenfeld knew when he was creating the Rosenfeld Trust that he was creating a concentration in Pep Boys stock. He was personally involved in the administration of the Trust for the final ten years of his life without diversifying its investments. Emanuel Rosenfeld's personal wealth was deeply entwined with the performance of Pep Boys. Faith in the performance of that single company was not a new concept to Emanuel Rosenfeld; indeed, he funded all of the trusts that he created — not only for charitable purposes, but also the trusts for the benefit and well–being of his close family members — entirely with Pep Boys stock.

If concentration in Pep Boys stock alone was a compelling reason to diversify in 1997, it would also have been a compelling reason to diversify in 1952, when the Rosenfeld Trust was funded. Yet, as the performance of Pep Boys stock from 1952 through 2003 demonstrated, volatility and risk offer the potential of positive as well as

negative effect, as the amazing increase in value of Pep Boys stock over that period vividly demonstrates.

The duty to diversify that the Orphans' Court purports to have found in the language of the Trust–creating document that Pep Boys founder Emanuel Rosenfeld drafted and executed is nowhere to be found in that document's plain language or intent. Had Emanuel Rosenfeld believed that diversification was important, he could have initially funded the Trust with diversified assets. He could have advocated diversification of the Trust himself during the first ten years of the Trust's existence. Or, he could have expressly written a diversification requirement into the Trust–creating document's plain language. Nothing would have been easier to do had the settlor so intended. Emanuel Rosenfeld did none of these things.

In this vociferously litigated case, it is noteworthy that neither Mrs. Stein nor Wachovia argued to the Orphans' Court that the Trust–creating document imposed a duty on the co–trustees to diversify. Indeed, in seeking summary judgment, Wachovia argued persuasively that no such duty arose under the Trust instrument, and Mrs. Stein did not argue to the contrary in that regard in opposing Wachovia's summary judgment motion. R.61a–64a, 80a–99a (Wachovia's s.j. brief; Mrs. Stein's brief in opposition thereto). The Orphans' Court has plucked from thin air its holding that the Trust–creating document imposed an obligation on the co–trustees to diversify the investments of a Trust funded with a concentration of highly volatile stock. The plain language of the Trust–creating document contains no such diversification requirement, and the failure of any party to the action to argue in the Orphans' Court that the Trust–

creating document did impose such a duty further corroborates that no such duty exists under the Trust instrument.

Because the duties that the Orphans' Court purported to draw from the language and purpose of the Trust–creating document are nowhere to be found in that language and purpose, the Orphans' Court erred in holding that Lester and Robert Rosenfeld breached those supposed duties.

2. Applicable Pennsylvania law imposed no duty on the Trustees to diversify the Trust's investments

Although the Orphans' Court's Adjudication correctly refuses to hold that applicable law required diversification of the Rosenfeld Trust's investments in 1997 (*see* Adjudication at 28–29), a review of Pennsylvania law is nonetheless useful to demonstrate just how seriously flawed the Orphans' Court's holding that diversification was required happens to be.

Pennsylvania law offers no applicable precedent for the proposition that it is imprudent *per se* for volatile, concentrated investments to predominate the holdings of a charitable foundation. To begin with, no statutory law imposes a requirement to diversify the holdings of the Rosenfeld Trust. As the Orphans' Court correctly recognized, it was not until 1999 that Pennsylvania's Legislature adopted the so–called Prudent Investor Rule set forth in 20 Pa. Cons. Stat. Ann. §§7201–7214. Although Section 7204 provides that a "fiduciary shall reasonably diversify investments," the statute by its own terms only applies to trusts that became irrevocable on or after December 24, 1999. *See* 20 Pa. Cons. Stat. Ann. §7204(b)(1). Moreover, this brand new

statute expressly does not apply to a concentration in stock created by the settlor of a trust even if the trust becomes irrevocable on or after December 24, 1999. *See* 20 Pa. Cons. Stat. Ann. §7205. As a result, Pennsylvania's statutory Prudent Investor Rule's requirement for reasonable diversification, by its own terms, has no application to the Rosenfeld Trust. *See Sky Trust*, 868 A.2d at 480 (recognizing that Prudent Investor Rule statute does not apply to trusts, such as the Rosenfeld Trust, that became irrevocable before December 24, 1999).

Because there is no statutory requirement of diversification applicable to the Rosenfeld Trust, it is necessary to turn next to case law addressing the question. The case most directly on point is this Court's ruling from 1994 in *Estate of Pew*, 655 A.2d 521 (Pa. Super. Ct. 1994). In that case, this Court confronted a claim for surcharge contending that the trustees' decision to retain Sun Oil Company and Oryx stock as the trust's sole investments benefited the trust's income beneficiary at the expense of the trust's remaindermen, and that instead the trustees should have diversified the trust assets so as to benefit equally the income beneficiary and the remaindermen. *See id.* at 543. Moreover, the bank serving as trustee in *Pew* had advised other of its clients to sell these stocks before the stocks appreciably declined in value, but the bank had failed to recommend that the Pew Trust sell those stocks. *See id.*

In considering and rejecting that argument, this Court quoted from the Pennsylvania Supreme Court's ruling in *Estate of Knipp*, 489 Pa. 509, 414 A.2d 1007 (1980):

> It is not, however, per se imprudent for an executor, vested with absolute discretion to hold property, to refrain from immediately diversifying a large block of stock received at the commencement of administration. In *Saeger's Estates*, 340 Pa. 73, 76-77, 16 A.2d 19, 21-22 (1940), where a surcharge was sought solely on the ground that the trustee had not diversified holdings, we said:
>
> > Nor does it appear that in any case thus far brought before this Court has a trustee been surcharged solely for the reason now urged. In the absence of controlling precedent and particularly in the absence of such requirement in the statutory law relating to the investment of trust funds, we conclude that . . . there is no authority in the law of this State for the doctrine, contended for by appellants, that trust investments, otherwise legal and entirely proper under all the recognized standards, are necessarily improvident per se for any claimed lack of proper diversification.

Id. at 513–14, 414 A.2d at 1009.

In *Pew*, this Court recognized that "The primary duty of a trustee is the preservation of the assets of the trust and the safety of the trust principal." *Pew*, 655 A.2d at 542. This Court went on to hold that because "the value of the trust principal increased more than nine-fold during the trustees' and co-successor trustees' management of the trust," "the trustees and co-successor trustees cannot be held to have breached their fiduciary duty regarding the preservation of the trust assets by retaining the Sun Company common stock throughout the lifetime of Walter C. Pew." *Id.* at 543.

Not only did this Court in *Pew* hold that trustees had no legal obligation to diversify the holdings of a trust when those holdings were serving the desired purposes of producing income and growing the trust's principal, but this Court also went on to hold that interim setbacks in the price of stock held by a non–diversified trust do not

allow for the assessment of a surcharge against the trustees for failure to diversify if the long–term performance of the trust's assets has been profitable. This Court's discussion of that issue deserves to be quoted at length:

> A trustee cannot be surcharged for a breach of duty unless the breach caused a loss to the trust. *In re Mendenhall*, 484 Pa. 77, 82 n. 3, 398 A.2d 951, 954 n. 3 (1979). One who seeks to surcharge the trustee for breach of trust must bear the burden of proving the particulars of the trustee's wrongful conduct. *Estate of Stetson*, 463 Pa. 64, 84, 345 A.2d 679, 690 (1975). *In re Estate of Feinstein*, 364 Pa. Super. 221, 230, 527 A.2d 1034, 1038 (1987). The propriety of an investment by a trustee must be judged as it appeared at the time it was made and not as viewed in the light of subsequent events. *In re Glauser's Estate*, 350 Pa. 192, 202, 38 A.2d 64, 69 (1944); *In re Saeger's Estate*, *supra*, 340 Pa. at 75-76, 16 A.2d at 21. The mere retention of stocks which the trustee received from the settlor is not, in itself, negligence. *In re Clabby's Estate*, 338 Pa. 305, 314, 12 A.2d 71, 75 (1940). Especially when such stocks have produced a high rate of return for the trust over an extended number of years. *Id.* at 314, 12 A.2d at 75. Hindsight is not the test of liability for surcharge. *Estate of Knipp*, *supra*, 489 Pa. at 512, 414 A.2d at 1008. *Mereto Estate*, 373 Pa. 466, 469, 96 A.2d 115, 116 (1953). To make after–sight the sole judge of the trustee's prudence would be manifestly unfair. *In re Clabby's Estate*, *supra*, 338 Pa. at 315, 12 A.2d at 75.
>
> Instantly, under the appellant's view of the law, the co–successor trustees must be deemed liable for a surcharge because the market value of Sun Company common stock and Oryx common stock diminished during the time period covered by the supplement to the Third Account. Under the appellants' theory of trustee liability for surcharge, the reviewing court should disregard the long–term performance of a stock which is part of the trust principal and focus instead upon its short–term performance during a narrow time period, and if the value of the stock declines, the trustees are subject to a surcharge for the loss. This Court declines to adopt such a view of the law, and will review the co-successor trustees' liability for a surcharge based upon their long–term performance.

Pew, 655 A.2d at 543–44.

This Court proceeded to hold in *Pew* that because the value of the trust, notwithstanding the complained of interim decline in the value of the trust's stock

holdings, was five times greater than the value of the trust when established by the settlor, no breach of duty occurred due to the trustees' failure to diversify. This Court explained, "the co-successor trustees' decision to retain the Sun Company and Oryx common stock has, over the long term, proven beneficial to the overall growth of the trust principal, and in light of this strong performance during the existence of this trust, the decline in the prices of these stocks during the short period covered by the supplement to the Third Account cannot be utilized as a basis for the appellants' allegations that the co-successor trustees breached a duty which caused a loss to the trust." *Id.* at 544.

In concluding its discussion of the issue, this Court in *Pew* wrote:

> [I]t would be manifestly unfair of this Court to permit trust beneficiaries, armed with the twenty–twenty laser–like vision of hindsight, to focus in upon any short term time period during the course of the trust's administration when the price of the stocks forming the trust principal had declined as a basis for subjecting the trustees to a surcharge for failing to sell the stocks, when the overall long–term performance of the same stocks led to a five–fold growth in the value of the trust principal. Therefore, the appellants have failed to allege sufficient facts in their objections that the trustees' breach of duty caused a loss to the trust and the trial court properly dismissed this objection.

Id.

More recently, in *In re McCune*, 705 A.2d 861 (Pa. Super. Ct. 1997), this Court cited with approval to its earlier holding in *Pew* in the course of rejecting a surcharge claim asserted by objectors who argued that the trustees' failure to diversify the trust holdings in that case resulted in a failure to realize the higher rate of return that diversification would have achieved. This Court rejected the objectors' argument,

explaining that the objectors "cannot base [their] allegations of an unrealized return solely on the 'retention of stocks which the trustee received from the settlor' because mere retention of this stock does not constitute negligence on the part of the trustee." *Id* at 866.

In mistakenly perceiving a legal obligation to diversify in this case, the Orphans' Court erroneously believed that two fairly recent three–judge panel rulings of this Court undermined the authority of this Court's earlier decision in *Pew*. The Orphans' Court's conclusion in that regard, however, is fatally flawed for three separate reasons. First, both of the recent rulings in question (which we shall turn to examine in more detail momentarily) cite *Pew* favorably for the proposition that diversification is not legally required. Second, a later three–judge panel's ruling of this Court cannot overrule or limit an earlier three–judge panel's ruling, and thus neither of these two more recent rulings could have affected *Pew*'s precedential effect even had they not both cited *Pew* favorably. *See Commonwealth* v. *Pepe*, 897 A.2d 463, 465 (Pa. Super. Ct. 2006) ("[i]t is beyond the power of a Superior Court panel to overrule a prior decision of the Superior Court"). And, third, both of these two more recent rulings are clearly distinguishable, while *Pew* remains precisely on point.

In this Court's ruling from 2005 in *Sky Trust*, 868 A.2d 464, this Court upheld the imposition of a surcharge on a trustee whom the Orphans' Court had found acted in breach of his duty when he diversified the holdings of an especially concentrated trust. Thus, the facts in *Sky Trust* are essentially the opposite of the facts here: in *Sky Trust* a

surcharge was imposed because the Orphans' Court found that diversification constituted a breach of fiduciary duty.

This Court's opinion in *Sky Trust* recognizes that while diversification of a trust's assets may be a favorable strategy, it was not an appropriate strategy to employ given the particular facts and circumstances of that case, where the life tenant needed a high rate of income that the earlier, undiversified stock had provided, and it was unlikely that the trust would remain in existence long enough for a diversified portfolio to make a positive difference in the amount of assets that would be available to the trust's remaindermen.

This Court's opinion in *Sky Trust* explained:

> [T]his is not a case in which Trustee actually exercised its discretion and determined that diversification was necessary in the short term to protect the assets and to preserve Life Tenant's income stream. The Trustee made no such determination. Rather, as the trial court concluded, this is a case in which Trustee applied a hypothetically "good" strategy under specific circumstances and in a manner that made the particular diversification program selected a "grossly negligent" course of conduct. There was no short–term danger to the safety of the trust's assets requiring immediate sale of the SKYF stock to protect the trust principal. Furthermore, it is clear that Trustee had no factual basis for expanding the Trust's horizon because the Life Tenant's health indicated that the total liquidation of the Trust would be required in the near term. Simply put, there were no reasonable prospects that the Trust could continue in existence long enough to experience capital growth from the chosen diversification strategy and it was gross negligence to sell safe and high performing assets in the implausible hope that a long–term capital gain could be realized. Under these circumstances, we cannot agree with Trustee that the trial court committed either an error of law or an abuse of discretion in determining that a surcharge ought to be imposed in this case.

Id. at 492.

Thus, *Sky Trust* stands for the proposition that a trustee can be surcharged for implementing a plan of diversification that is not tailored to the circumstances of the trust's beneficiaries if the beneficiaries sustain a loss as a result of that diversification. The case does not stand for the proposition that diversification is required under Pennsylvania law if a trust is overly concentrated in a single volatile stock, nor does the case establish a requirement to diversify where the trustees are deadlocked over whether diversification is an appropriate circumstance.

The other case that the Orphans' Court viewed as curtailing the precedential value of this Court's decision in *Pew* was this Court's decision in *In re Estate of Scharlach*, 809 A.2d 376 (Pa. Super. Ct. 2002). *Scharlach*, like *Sky Trust*, in fact cites *Pew* repeatedly with favor, and thus the Orphans' Court was mistaken to view *Scharlach* as contrary to *Pew* in any respect.

The *Scharlach* case involved a boy who was severely incapacitated due to medical malpractice that occurred immediately after his birth. A medical malpractice action pursued on the child's behalf produced a cash recovery in the amount of $800,000. A Pennsylvania court appointed a local bank to serve as guardian to manage the proceeds of the malpractice recovery. In appointing the bank as guardian, the trial court entered an order providing:

> First Eastern Bank is directed to invest as guardian the corpus of the incompetent's estate no more than One Hundred Thousand ($100,000) in any single investment, other than investments in direct obligations of the United States Government. First Eastern Bank is hereby granted leave to petition this Court for an amendment to this Order should conditions merit an appropriate adjustment of the investment scheme for the assets.

809 A.2d at 378.

From the inception of the guardianship in 1990 until the bank petitioned for permission to invest in equities and other investments in the year 2000, the bank kept the principal continually invested in federally–insured obligations of the U.S. Government. In December 2000, after having been relieved from the guardianship, the bank filed its final account. The boy's mother objected to the account, maintaining that the bank had breached its duty to invest the assets prudently to produce the growth and income necessary to address her son's needs into the future. The mother's objection also noted that she had put the bank on notice of the boy's continuing financial requirements by providing the bank at the outset of its guardianship with a copy of a comprehensive report that an investment consultant had prepared.

This Court ruled in *Scharlach* that the bank was liable to be surcharged because it invested the guardianship assets in federal government obligations that the bank knew were insufficient to produce the sort of returns required to meet the future needs of the boy who was the beneficiary of the guardianship. This Court's opinion explains:

> The actions of Appellee bear no resemblance to the actions of the fiduciaries in the cases upon which it relies, where the fiduciaries were found to have met the standard of care required of them, even though, in hindsight, alternative investments would have yielded higher return. Those fiduciaries followed investment strategies that were well–considered when implemented. *See*, *e.g.*, *Pew*, *supra*.
>
> In the present case, however, Appellee ignored the sound and considered plan that was prepared at its direction in 1990 by Mr. Sykes. Appellant is not seeking damages for alternative investments. She seeks the loss that Mr. Scharlach sustained due to [the bank's] failure to follow the very investment plan that it requested.

Id. at 385.

This Court also distinguished its result from the Pennsylvania Supreme Court's holding in *Knipp* that Pennsylvania common law recognizes no *per se* duty to diversify the assets of a trust:

> [I]n the present case, Appellant is hardly complaining that Appellee breached its duty *per se* for failing to diversify. Appellant contends that Appellee breached its fiduciary duty by failing to invest the assets of the guardianship in accordance with the investment plan that it ordered, and that the documents of record irrefutably establish was reasonably designed to meet the incompetent's needs. The principles at issue in *Knipp* have no application herein.

Id. at 387.

This Court's opinion in *Scharlach* is also significant for the fact that it permitted a surcharge to be recovered in the absence of any actual loss of principal, to make up for the comparative loss due to the guardian's failure to invest in a concrete, alternative proposed investment that indisputably would have been appropriate for the beneficiary, while the alternate form of investment actually utilized by the guardian was known to the guardian as never appropriate to serve the beneficiary's interests.

Unlike in *Scharlach*, no one has ever contended that Pep Boys stock was an investment that was incapable of accomplishing the long–term goals of the Rosenfeld Trust, and that stock's superior performance over the long–term readily refutes any such contention. At the time First Union initially raised for discussion the issue of possible diversification, in September 1997, the value of Pep Boys stock was at a historically high price. There was no suggestion that Pep Boys was an inappropriate investment for the Trust; First Union was merely suggesting that diversification might

be preferable for the future, even though it assuredly would not have been preferable over the first forty–five years of the Trust's existence. Unlike in *Scharlach*, where the guardian could not reasonably believe that the decision to invest solely in U.S. Government–secured obligations was in the beneficiary's best interest, here trustees could and did reasonably conclude that having Pep Boys as the Trust's central holding remained advisable.

This Court's holding in *Pew* squarely controls the outcome of this case. There, this Court recognized that there is no common law requirement to diversify the assets of a highly concentrated trust where the trust is serving the purposes for which it was created. This Court reaffirmed that holding in *Sky Trust*. Moreover, in *Pew*, this Court also recognized that a temporary downturn in the value of a trust's assets does not give rise to liability for surcharge where the performance of the trust's assets over the complete period under consideration shows an increase in value. The increase in value that occurred in *Pew* was miniscule when compared to the far greater increase in value in the holdings of the Rosenfeld Trust from its inception through the time of Wachovia's first account in 2004.

The Orphans' Court attempted to overcome the prohibition on using hindsight to condemn a trustee's investment decisions by latching on to the fact that First Union in its September 1997 letter alluded to what "a contemporary asset allocation for a foundation of this size and sophistication might resemble" followed by the identification of several generalized asset classes that could be used to construct a more diversified portfolio. R.1328a (Ex. P–34). Under the Orphans' Court's approach in this

case, had the trustees in *Pew* been presented with a generalized hypothetical diversification proposal before the concentrated stock at issue in that case suffered an interim decline in value, those trustees would have been obligated to comply with the plan and, failing to do so, would be liable for surcharge in the amount of that decline. The holding in *Pew* does not contemplate any such thing, and the Orphans' Court's approach would, in essence, turn trustees into guarantors so that when faced with the suggestion that an alternate investment approach exists, they will be held personally liable for making up the difference if they fail to pick the approach with the higher return.

In *Scharlach*, it is important to recall, the guardian was not faced with a choice between two alternate appropriate investments. Rather, in *Scharlach*, one investment was unquestionably inappropriate to serve the beneficiary's financial interests, and that is the investment the guardian chose. Similarly, in *Sky Trust*, it was inappropriate for the trustee to have opted for diversification instead of keeping the trust's assets highly concentrated as they had always been. Here, by contrast, Pep Boys stock unquestionably was a sound investment as of September 30, 1997, and no one has ever contended that holding Pep Boys stock threatened the principal of the Rosenfeld Trust or represented an improper way to accomplish the Rosenfeld Trust's goals. The superior performance of Pep Boys stock over the existence of the Trust conclusively refutes any such contention.

* * * * *

As demonstrated above, neither the language of the Trust–creating document nor applicable Pennsylvania law imposed any duty on the trustees of the Rosenfeld Trust to diversify or to reach a majority view in favor of diversification merely because at some point two of the four trustees had concluded that diversification was preferable. As a result, this Court should reverse the Orphans' Court's conclusion that Lester and Robert Rosenfeld breached their fiduciary duties to the Trust and can be held liable for surcharge.

B. The Orphans' Court Erred In Holding That The Rosenfelds' Supposed Breach Of Duty Caused Damage To The Trust

Pennsylvania law unambiguously provides that a trustee can be surcharged only if his or her breach of duty has caused a loss to the trust. *See In re Mendenhall*, 484 Pa. at 82 n.3, 398 A.2d at 954 n.3; *Pew*, 655 A.2d at 240.

Here, it is clear that any interim decline in the value of Pep Boys stock, or lag in the performance of that stock when compared to other market indices, did not cause the Rosenfeld Trust to sustain any loss. Moreover, the evidence that Mrs. Stein introduced in the Orphans' Court to establish a loss to the Rosenfeld Trust was, as the Orphans' Court itself later recognized, entirely insufficient to prove any loss, even on an interim basis. And finally, even if one accepts the Orphans' Court's conclusion that the Rosenfelds breached their duty to the Rosenfeld Trust, the facts of record do not support the conclusion that the Trust sustained any damage or loss as a result.

1. Under this Court's decision in *Pew*, an interim decline in the value of an undiversified trust's holdings does not give rise to liability for surcharge where, over the entire accounting period, the trust's value has increased

In *Pew*, this Court squarely held that interim setbacks in the price of stock held by a non–diversified trust do not allow for the assessment of a surcharge against the trustees for failure to diversify if the long–term performance of the trust's assets has been profitable.

This Court recognized that "The primary duty of a trustee is the preservation of the assets of the trust and the safety of the trust principal." *Pew*, 655 A.2d at 542. This Court specifically held that because "the value of the trust principal increased more than nine–fold during the trustees' and co-successor trustees' management of the trust," "the trustees and co–successor trustees cannot be held to have breached their fiduciary duty regarding the preservation of the trust assets by retaining the Sun Company common stock throughout the lifetime of Walter C. Pew." *Id.* at 543.

Pew expressly rejected the contention that interim setbacks in the price of stock held by a non–diversified trust allow for the assessment of a surcharge against the trustees for failure to diversify even if the long–term performance of the trust's assets has been profitable:

> Instantly, under the appellant's view of the law, the co–successor trustees must be deemed liable for a surcharge because the market value of Sun Company common stock and Oryx common stock diminished during the time period covered by the supplement to the Third Account. Under the appellants' theory of trustee liability for surcharge, the reviewing court should disregard the long–term performance of a stock which is part of the trust principal and focus instead upon its short–term performance during a narrow time period, and if the value of the stock

> declines, the trustees are subject to a surcharge for the loss. This Court declines to adopt such a view of the law, and will review the co-successor trustees' liability for a surcharge based upon their long–term performance.

Pew, 655 A.2d at 543–44.

This Court held in *Pew* that because the value of the trust, notwithstanding the complained of interim decline in the value of the trust's stock holdings, was five times greater than the value of the trust when established by the settlor, no breach of duty occurred due to the trustees' failure to diversify. This Court explained, "the co-successor trustees' decision to retain the Sun Company and Oryx common stock has, over the long term, proven beneficial to the overall growth of the trust principal, and in light of this strong performance during the existence of this trust, the decline in the prices of these stocks during the short period covered by the supplement to the Third Account cannot be utilized as a basis for the appellants' allegations that the co-successor trustees breached a duty which caused a loss to the trust." *Id.* at 544.

In concluding its discussion of the issue, this Court in *Pew* wrote:

> it would be manifestly unfair of this Court to permit trust beneficiaries, armed with the twenty–twenty laser–like vision of hindsight, to focus in upon any short term time period during the course of the trust's administration when the price of the stocks forming the trust principal had declined as a basis for subjecting the trustees to a surcharge for failing to sell the stocks, when the overall long–term performance of the same stocks led to a five–fold growth in the value of the trust principal. Therefore, the appellants have failed to allege sufficient facts in their objections that the trustees' breach of duty caused a loss to the trust and the trial court properly dismissed this objection.

Id.

This Court's holding in *Pew*, when applied to the facts of this case, demonstrate beyond peradventure that the Orphans' Court erred when it held that the Rosenfeld Trust suffered a loss due to a failure to diversify. The holdings of the Rosenfeld Trust, it is undisputed, grew 250–fold from the start of the audit period in 1953 through the end of the audit period in 2004. Not only does that increase unambiguously evidence tremendous growth, but that tremendous growth outperformed the S&P 500 market index by a ratio of five–to–one during that same period. What these facts show is that, under *Pew*, any interim downturn or market lag in the value of Pep Boys stock fails, as a matter of law, to subject the Rosenfelds to surcharge.

The Orphans' Court, however, rejected application of this Court's precedent in *Pew* in favor of this Court's more recent, but substantially less apposite, ruling in *Scharlach*. *See* Adjudication at 40–41. The reason why *Scharlach* is irrelevant has already been discussed above. There, the bank serving as guardian invested the minor's settlement proceeds in U.S. Government–backed assets that were indisputably inappropriate to meet the minor's future needs during the entire period of the investment. Accordingly, this Court held that the bank could be surcharged for the loss that resulted when the bank failed to invest the proceeds of settlement in an alternate, diversified group of investments contained in a timely, concrete proposal that the bank should have instead followed from the outset.

The reason why *Scharlach* provides no support for the Orphans' Court's decision here to surcharge the Rosenfelds for an interim decline or market lag in the value of Pep Boys stock is that, unlike in *Scharlach*, it cannot be demonstrated here that Pep Boys

never was an appropriate investment for the Rosenfeld Trust or even that Pep Boys was an inappropriate investment when the idea of diversifying was raised for possible discussion in late 1997. In late 1997, Pep Boys was at a historically high price. Moreover, the Trust's concentration in Pep Boys outperformed the overall stock market from start of the audit period through the audit period's conclusion by a margin of five–to–one. Reasonable minds could disagree in late 1997, 1998, and 1999 whether it was preferable for the Rosenfeld Trust to remain concentrated in Pep Boys stock or to diversify. First Union's letter of September 30, 1997 understood that the price of Pep Boys stock was likely to continue to exhibit strength. R.1328a (Ex. P–34). That makes this case entirely distinguishable from *Scharlach*, where the bank's selection of an investment vehicle was inappropriate the entire time.

For these reasons, in accordance with *Pew*, this Court should hold that the Rosenfelds' supposed breach of their fiduciary duties did not cause the Rosenfeld Trust to sustain any loss or damages, and therefore the Orphans' Court's assessment of a surcharge should be overturned.

2. Mrs. Stein, the lone proponent of a surcharge against the Rosenfelds, failed to introduce the evidence necessary to allow the Orphans' Court to calculate damages, and therefore the Orphans' Court should have entered judgment in favor of the Rosenfelds

At the outset of the damages phase of the hearings, before Mrs. Stein's proposed damages expert, Dr. McCann, took the witness stand, the Rosenfelds presented to the Orphans' Court a motion *in limine* to preclude Dr. McCann's testimony.

In that motion *in limine*, the Rosenfelds raised three arguments. R.587a–93a (motion *in limine*). First, Dr. McCann's damages calculations were not anchored in the facts of record concerning when a breach of the supposed duty to diversify occurred. Rather, in a transparent attempt at generating damages figures that were as large as possible, Dr. McCann assumed that the Rosenfelds' breach of the duty to diversify occurred either on June 30, 1996, more than a year before First Union Bank first raised the subject of diversification for discussion, or on October 1, 1997, one day after First Union mailed its letter first suggesting that the trustees should discuss the possibility of diversification.

Second, the motion *in limine* argued that Dr. McCann's calculations, in another transparent attempt to generate damages that were as large as possible, assumed that the sale of all but ten percent of Pep Boys stock would occur over a six–month period, even though there was no evidence in the record that this was what any party had urged or intended to implement.

And third, the motion *in limine* noted that Dr. McCann's calculation of damages was based on his hypothetical determination of what a diversified portfolio would reflect, and that hypothetically diversified portfolio had absolutely no basis in the evidence.

The Orphans' Court denied the Rosenfelds' motion *in limine*, and as a result considered Dr. McCann's testimony. However, when the Orphans' Court issued its Adjudication on July 31, 2006, the Orphans' Court's ruling specifically agreed with the

first two grounds the Rosenfelds had offered for precluding Dr. McCann from testifying. *See* Adjudication at 44, 50–51.

First, the Orphans' Court agreed that the June 30, 1996 start date for calculating damages was entirely inappropriate. *Id*. at 44. And second, the Orphans' Court agreed that Dr. McCann's use of a six–month diversification timetable was inappropriate, and that Dr. McCann instead should have used the two–year diversification timetable alluded to in First Union's letter dated September 30, 1997. *Id.* at 50–51. The Orphans' Court's Adjudication also recognized that there was an issue concerning whether Dr. McCann's loss calculation was based on any diversification model that the evidence would support, but the Orphans' Court inexplicably concluded that whatever deviation existed was insignificant. *Id.* at 52–57.

Due to the Orphans' Court's recognition that Dr. McCann's damages testimony was not based on the evidence, the Orphans' Court should have ruled that Dr. McCann's damages figures did not provide an appropriate basis on which to calculate the surcharge amount to be assessed against the Rosenfelds. At that juncture, because Mrs. Stein was the proponent of a surcharge and because Mrs. Stein's evidence did not permit the Orphans' Court to ascertain whether the Rosenfelds' supposed breach of duty caused damage or a loss to the Rosenfeld Trust, the Orphans' Court should have entered judgment in favor of Lester and Robert Rosenfeld. By failing to do so, the Orphans' Court committed reversible error. *See Slappo* v. *J's Devel. Assocs., Inc.*, 791 A.2d 409, 415 (Pa. Super. Ct. 2002) ("the plaintiff has a duty to present sufficient evidence from which a jury can compute the proper amount of damages with reasonable

certainty"); *Gordon* v. *Trovato*, 338 A.2d 653, 654 (Pa. Super. Ct. 1975) ("It is the burden of the plaintiff to establish by evidence such facts as will furnish a basis for the legal assessment of damages according to some definite and legal rule.").

To be sure, Pennsylvania law provides that where a defendant is liable for causing harm but the damages resulting from that harm cannot be established with precision, a plaintiff merely must introduce evidence affording the finder of fact a reasonable basis on which to calculate the amount of damages. *See Pugh* v. *Holmes*, 486 Pa. 272, 297, 405 A.2d 897, 909–10 (1979). Here, the Orphans Court ruled that the Rosenfelds breached their duty by failing to agree to diversify the Trust's investments in response to the Bank's letter dated September 30, 1997. We discuss in detail in the following section of this Brief why First Union's letter of September 30, 1997 cannot sustain the great weight that the Orphans' Court's Adjudication assigns to it. But even if, assuming *arguendo*, that letter could be viewed as the Orphans' Court has perceived to propose an alternate diversified portfolio for the Trust's investments, it is clear that Mrs. Stein's damages expert neither attempted to nor did tailor his damages calculations to adhere to the example of a diversified portfolio that the Bank's letter contained.

First Union's September 30, 1997 letter stated, in pertinent part:

> In order to facilitate this diversification, we recommend reducing Pep Boys Stock to less than 10% of the equity portion of the portfolio within two years, potentially taking advantage of any strength in the stock price of Pep Boys to accelerate this process. In any event, there should be a regular program of divestment.

> As to the investment of the proceeds, a contemporary asset allocation for a foundation of this size and sophistication might resemble the following:
>
> | | | |
> |---|---|---|
> | | 40% | Large Cap Blend |
> | | 15% | Mid/Small Cap |
> | | 10% | International Equity |
> | Equity | 65% | |
> | Fixed Income | 35% | |
> | Total | 100% | |
>
> While we would recommend using funds to meet this allocation and gain diversification, the large capitalized portion of the equity portfolio as well as the bond portion may be individually managed if you so desire.

R.1328a (Ex. P–34).

Dr. McCann's damages calculations, by contrast, were based on his view of what a hypothetically good diversified portfolio would consist of: 65% invested in Vanguard's S&P 500 index fund, and 35% invested in Vanguard's total bond fund. Dr. McCann admitted during his testimony that he did not attempt to replicate the investment allocations mentioned in First Union's September 30, 1997 letter. R.982a (T.T. 5/3/05 at p. 52). Dr. McCann further admitted that his hypothetically good diversified portfolio reflected neither a "15% Mid/Small Cap" component nor a "10% International Equity" component. R.1032a–33a (*id.* at 102–03).

Off the top of his head, under questioning from the Orphans' Court judge, Dr. McCann stated that he believed that during the periods over which he calculated damages, the Wilshire 5000 Index (an index that does contain mid and small cap stocks) produced a return that did not deviate by more than one percent from the return produced by the S&P 500. R.1036a (*id.* at 106). Yet this was a point for which concrete

proof was unquestionably available, and one expert's unsubstantiated belief as to whether those two indices performed similarly over the periods in question is not entitled to any weight. This is especially so given that the Rosenfelds' highly credentialed damages expert, Dr. Postlewaite, testified during the very same hearings that he did not believe that Dr. McCann's off–the–cuff remark that the S&P 500 and the Wilshire 5000 produced similar returns during the periods in question was accurate or reliable. R.1211a–15a (T.T. 5/4/05 at 122–26).

If the Orphans' Court correctly concluded that the Rosenfelds deserved to be surcharged for refusing to diversify as of September 30, 1997 because of the letter that First Union sent on that date, then at a minimum the law requires that the damages calculation be based on the type of diversified portfolio that First Union provided as an example in that letter. The Orphans' Court did not disagree with this point; rather, the Orphans' Court merely found that Dr. McCann's own hypothetically good diversified portfolio was close enough for government work. *See* Adjudication at 57.

Yet, as should be painfully clear by this point, Dr. McCann did not attempt to replicate the diversification allocation mentioned in First Union's September 1997 letter. Furthermore, Dr. McCann did not testify that it was impossible to calculate damages based on a diversification proposal whose equity component consisted of "40% Large Cap Blend," "15% Mid/Small Cap" component nor a "10% International Equity," and indeed it surely would have been possible for Mrs. Stein's damages expert to present the Orphans' Court with such a calculation. Rather, Dr. McCann, because it required less effort (R.982a (T.T. 5/3/05 at p.52)), decided to present the Orphans' Court with

damages calculations based solely on a "65% Large Cap Blend," which is what the S&P 500 represents. There is no possible way to read First Union's letter of September 30, 1997 to propose that manner of diversification. Indeed, at the time of the damages hearing, the Orphans' Court recognized this critical flaw in Dr. McCann's testimony, as reflected in the following question that the Orphans' Court judge posed to Dr. McCann:

> THE COURT: Why wouldn't the analysis of damages predicated upon those facts in this case be a more logical approach to the damage calculation than the one you offer based upon what you[r] advice would have been to the parties had you been invited to offer?

R.986a (T.T. 5/3/05 at p. 56).

In *Collins* v. *Hand*, 431 Pa. 378, 390, 246 A.2d 389, 404 (1968), the Supreme Court of Pennsylvania ruled that "[a]n expert cannot base his opinion upon facts which are not warranted by the record. No matter how skilled or experienced the witness may be, he will not be permitted to guess or state a judgment based on mere conjecture."

Here, the Orphans' Court's opinion states: "In exercising its legal discretion, this court concludes that the portfolio selected by Dr. McCann to mirror the bank's proposed investment into 65% equity/35% bond was as accurate as possible under the circumstances." Adjudication at 57. That conclusion cannot be sustained on appeal, because even the Orphans' Court admits that Dr. McCann's calculation includes no international stock component, and the parties' experts are sharply divided over the accuracy and reliability of Dr. McCann's unsupported, off–the–cuff belief that the S&P 500 and the Wilshire 5000 produced similar returns during the periods in question so

that Dr. McCann's approach could be understood as capturing any mid or small cap component.

To be sure, a reasonable basis for assessing damages is all that Pennsylvania law requires in cases where accuracy cannot be achieved. But here Mrs. Stein's expert witness never attempted to establish damages with accuracy, and substantially more accuracy could have been achieved by following the asset allocation mentioned in First Union's September 1997 letter. Mrs. Stein, as the party advocating the imposition of a surcharge, had the burden of proving damages but failed to do so. Accordingly, the Orphans' Court's conclusion that Dr. McCann's testimony provided a reasonable basis for calculating the amount of damages must be reversed and the surcharge vacated.

3. The Orphans' Court erred in selecting September 30, 1997 as the date on which the Rosenfelds breached a supposed duty to diversify

In concluding that the Rosenfelds breached the supposed duty to diversify as of September 30, 1997, the Orphans' Court erred. According to the Orphans' Court's Adjudication, "the bank's September 30, 1997 letter to the co–trustees stands as a *clear beacon* in putting the Rosenfelds firmly on notice of their duty to consider diversifying the Foundation's Fund and as setting forth a possible reinvestment scheme for 90% of the Pep Boys stock 'within two years, potentially taking advantage of any strength in the stock price of Pep Boys to accelerate this process.'" Adjudication at 48 (emphasis added).

The Orphans' Court's conclusion that First Union's three–page letter of September 30, 1997 constitutes a basis for establishing the breach of duty supposedly

dictated by the Trust instrument is no less inexplicable than the Orphans' Court's holding that the Trust instrument actually required the trustees to diversity the Trust's investment away from a concentration in Pep Boys stock. The letter cannot sustain the tremendous weight that the Orphans' Court's Adjudication has placed on it. First Union's letter, sent by the Bank when Pep Boys common stock was trading at a historically high price, merely raised as a subject for discussion sometime in the future the issue of possible diversification of the Trust's investments.

The letter (R.1327a–30a (Ex. P–34)) never mentions the terms of the Trust instrument. The letter never contends or even suggests that the trustees had a duty to divest Pep Boys stock for any reason or to implement diversification. The letter does recommend diversification to reduce the volatility of the portfolio, but that position merely reflected a view widely shared by bank trust departments with which reasonable people may disagree. Remember that even Pennsylvania's newly–enacted Prudent Investor Rule exempts new trusts created by the settlor with a concentration in a single stock from the otherwise newly–applicable statutory duty to diversify. *See* 20 Pa. Cons. Stat. Ann. §7205.

Because here there was no duty to diversify set forth in the Trust instrument, there could be no evidence of a breach of that duty established by ignoring or disagreeing with First Union's general recommendations set forth in the September 1997 letter. The September 1997 letter does not evidence a dialogue or deadlock among the trustees. There was no evidence during the hearings that the Rosenfelds even remembered receiving the letter. There was no testimony or other evidence of any

follow–up communications from First Union until over one year later, in October 1998. R.1366a (Ex. P–48). The letter also did not state whether Mrs. Stein was in favor of diversification or, if so, the period for diversification that she favored or the reinvestment strategy that she favored.

It is indeed remarkable that the Orphans' Court relies on First Union's isolated September 1997 letter as establishing a breach of duty without any testimony from the Bank officer who wrote the letter or any other corroborating evidence. Reginald Middleton, the only First Union employee to testify during the hearings, explicitly stated that the deadlock among the trustees on the issue of diversification did not begin until sometime in 1998. R.1564a; 743a (Ex. R–2; T.T. 1/26/05 at p.88).

Furthermore, it is absurd for the Orphans' Court to find Lester and Robert Rosenfeld to have breached a duty requiring them to engage in a thoughtful and careful exchange of ideas as of the very moment that First Union put in the mail the Bank's initial communication suggesting that a conversation or conversations on the subject of diversification should occur. Even if the Orphans' Court had allowed only a minimal two–month period for consideration of the concept of diversification and discussion amongst the co–trustees in an effort to reach consensus, and therefore set the date of the Rosenfelds' breach of duty at November 30, 1997 or later, the Trust's failure to diversify beginning on November 30, 1997 or during 1998 did not cause the Trust to sustain any loss. R.1622a (Ex. R–15). And, in the absence of any loss, no surcharge could be assessed.

* * * * *

Because, under *Pew*, the Rosenfeld Trust sustained no loss due to a temporary downturn or marginal underperformance of Pep Boys stock, because Mrs. Stein failed to introduce any evidence enabling the Orphans' Court to calculate a loss, and because the Orphans' Court's calculation of a loss is based on a breach of duty date that no permissible view of the evidence would support, this Court should reverse the Orphans' Court's assessment of a surcharge and remand for the entry of judgment in favor of Lester and Robert Rosenfeld.

C. The Orphans' Court Erred And Abused Its Discretion In Ordering That Lester Rosenfeld And Robert Rosenfeld Be Removed As Co–Trustees Of The Rosenfeld Trust

Under Pennsylvania law, as the Supreme Court of Pennsylvania has recognized, "the removal of a trustee is a drastic remedy, and the need for such action must be clear. [S]uch action must be viewed in conjunction with the settlor's expressed confidence in the trustee, evinced by the trustee's appointment. In a case where a settlor appoints a particular trustee, removal should only occur when required to protect the trust property." *In re White*, 506 Pa. 218, 223, 484 A.2d 763, 765 (1984). Similarly, Pennsylvania's highest court in *In re Croessant's Estate*, 482 Pa. 188, 193, 393 A.2d 443, 446 (1978) (citations omitted), explained that "Removal of a trustee is, however, a drastic action, and proof of the need for this remedy must be clear. Especially is this so where, as here, the person named as trustee enjoyed the special confidence of the decedent as evidenced by the specific appointment of the person as trustee in the will."

In this case, the Orphans' Court's decision to remove Lester Rosenfeld and Robert Rosenfeld as co–trustees of the Rosenfeld Trust was legally erroneous and an

abuse of discretion for three reasons. First, the central basis for the removal was the Orphans' Court's conclusions that the Rosenfelds had breached their fiduciary duties to the Trust and were liable for surcharge. For the reasons explained above, neither of those conclusions can withstand appellate review, and accordingly the order removing the Rosenfelds as co–trustees must be vacated.

Second, the removal constituted reversible error because the Orphans' Court did not provide the notice to the Rosenfelds that due process necessitated. *See In re Adoption of J.N.F.*, 887 A.2d 775, 781 (Pa. Super. Ct. 2005) (noting that due process requires "adequate notice [and] an opportunity to be heard"). Specifically, the Orphans' Court did not put the parties on notice that it intended to adjudicate the question of removal simultaneously with the question of surcharge. Thus, none of the parties argued the question of removal to the Orphans' Court during the course of the hearings, no expert testimony on the subject of removal was presented by any party, and the Adjudication's conclusion that removal was necessary was completely unexpected.

The Rosenfelds are not arguing that the evidence adduced at the hearings was entirely irrelevant to the issue of removal, nor are the Rosenfelds arguing that the Orphans' Court lacked the ability to adjudicate the question of removal on proper notice. All that the Rosenfelds are suggesting is that they deserved to have an opportunity to be heard by the Orphans' Court on the specific question of whether they should be removed as co–trustees, but no such opportunity to be heard on that issue was afforded to them.

The third and final point is related to the notice issue just discussed. The Orphans' Court's decision to remove the Rosenfelds as co–trustees issued on July 31, 2006 based on a record developed at hearings that concluded in early 2005. Various other critically important facts on which the Orphans' Court's removal decision were based — such as Lester Rosenfeld's supposed conflict of interest by remaining too connected to the day–to–day operations of Pep Boys; the rift in communications that had arisen between Lester and Robert Rosenfeld in early 2005; and the trustees' inability in early 2005 to decide how to reinvest the cash proceeds that resulted from diversifying from Pep Boys stock — had all changed between the time of the hearings in early 2005 and the time the Orphans' Court announced its adjudication in mid–2006 in ways that militated substantially against removal of the Rosenfelds as co–trustees.

Specifically, by mid–2006, Lester Rosenfeld ceased attending Pep Boys Board of Directors meetings. R.620a (Petition to Stay Removal at 7). By mid–2006, Lester and Robert Rosenfeld reconciled and began speaking with each other regularly, which they continue to do. R.618a (*id.* at 5). And by mid–2006, the Rosenfeld Trust, thanks entirely to the votes of Lester and Robert Rosenfeld and Wachovia, had reinvested the cash proceeds produced from the ongoing divestiture of the Trust's concentration in Pep Boys stock into a broadly diversified group of exchange–traded funds. *Id.*

Yet these changes in facts, which were not directly relevant to the surcharge issues that the Orphans' Court was known to be considering, were not brought to the Orphans' Court's attention in the context of the removal issue because the Rosenfelds

were not on notice that the question of removal was also about to be decided on the existing record without any specific opportunity for them to be heard on that question.

On the issue of removal, the main point remains that there was and is no actual endangerment to the Trust estate that merited the removal of Lester and Robert Rosenfeld as co–trustees. They did not engage in embezzlement, defalcation, or any other form of misconduct intended to enrich themselves or others at the expense of the Trust. Moreover, the Orphans' Court's own Adjudication recognizes that both Lester and Robert Rosenfeld acted properly in refusing to agree to sell Pep Boys stock at too low of a price, even though the other two remaining co–trustees were willing to sell at any price. *See* Adjudication at 16 ("After the price of Pep Boys stock sank, Lester's refusal to sell the stock was reasonable and justifiable. He naturally did not want to sell at too low a price."); *id.* at 18 (quoting letter from Robert Rosenfeld to First Union stating that "I am not opposed to diversifying the portfolio, although at Pep Boys current price, I would be against the timing.").

At most, the Rosenfelds were involved in a legitimate, good faith disagreement over whether retaining the Trust's concentration in Pep Boys stock or approving a plan of diversification was in the Trust's best interest. That was not an issue for which only one arguably correct answer exists, as the Trust's tremendous performance historically as a result of being concentrated in Pep Boys stock reveals.

Accordingly, this Court should reverse the Orphans' Court's removal of Lester and Robert Rosenfeld as co–trustees of the Rosenfeld Trust, because that order of removal was both legally erroneous and an abuse of discretion.

D. The Orphans' Court Erred And Abused Its Discretion In Assessing Against Lester And Robert Rosenfeld The Attorneys' Fees That Wachovia Bank Incurred In Defending Against Rita Stein's Unmeritorious Claims Against That Bank

The Orphans' Court's Adjudication contained one additional unpleasant surprise for the Rosenfelds, in that the court ruled that the Rosenfelds should pay the attorneys' fees Wachovia incurred in defending against Mrs. Stein's unmeritorious claims against the Bank for emotional distress, negligence, breach of fiduciary duty, and surcharge. None of these claims that Mrs. Stein asserted against the Bank even managed to survive past the summary judgment stage.

When Wachovia Bank applied to be reimbursed for the attorneys' fees that it incurred in defending against Mrs. Stein's unmeritorious claims against the Bank, the Bank did not argue or suggest that the Rosenfelds should be required to pay the Bank's fees. R.332a–39a; 364a–72a; 403a–38a (Wachovia's fee petitions). Mrs. Stein, in her responses to the Bank's attorneys' fee requests, did not argue or suggest that the Rosenfelds should be required to pay the Bank's fees. R.340a–57a; 373a–88a; 439a–57a (Mrs. Stein's responses to Wachovia's fee petitions). And, to be sure, the Rosenfelds never suggested that they should be required to pay the Bank's fees. Nor, prior to issuance of the Adjudication, did the Orphans' Court ever suggest it was considering whether the Rosenfelds should be required to pay the Bank's fees.

The Orphans' Court's failure to give notice that it was considering whether to require the Rosenfelds to pay Wachovia Bank's attorneys' fees and costs incurred in defending against Mrs. Stein's unmeritorious claims deprived the Rosenfelds of their

due process right to notice and an opportunity to be heard. *See In re Adoption of J.N.F.*, 887 A.2d at 781 (due process requires "adequate notice [and] an opportunity to be heard"). Had such an opportunity been provided, as due process required, the Rosenfelds' principal argument would have been that they should not be assessed liability for the Bank's fees, because the Rosenfelds' actions were neither the factual nor legal cause of Mrs. Stein's having asserted unmeritorious claims against Wachovia Bank.

No legal authority exists under Pennsylvania law for holding one tortfeasor liable for the attorneys' fees of another alleged co–tortfeasor who is found not liable. Mrs. Stein's misbegotten decision to sue a party not responsible for the injuries she sought to redress was a superseding cause that precludes the Rosenfelds, even in the unlikely event that they remain liable for the surcharge that the Orphans' Court assessed, from being held liable to pay Wachovia Bank's fees. The fees that Wachovia necessarily incurred in defending itself against Mrs. Stein's meritless claims should either be borne by Wachovia Bank under the traditional American Rule, whereby each litigant bears responsibility for its own attorneys' fees (*see Hart* v. *Arnold*, 884 A.2d 316, 342 (Pa. Super. Ct. 2005) ("Generally, litigants are responsible for their own counsel fees unless otherwise permitted by statutory authority, agreement of the parties, or some other recognized exception to the general rule.")), or the fees should be assessed against the Trust or Mrs. Stein, who is the only party who bears direct responsibility for Wachovia Bank's having to defend itself against unmeritorious claims. *See, e.g.*, *In re Francis Edward McGillick Foundation*, 537 Pa. 194, 204, 642 A.2d 467, 472 (1994)

(permitting a trustee to obtain indemnification from the trust for legal fees incurred in successfully defending against an unmeritorious surcharge and removal claim).

The Orphans' Court also erred as a matter of law in allowing Wachovia to receive reimbursement for a category of attorneys' fees known as "fees on fees," meaning the costs and expenses the Bank's counsel says it incurred in seeking to establish the entitlement to be paid for the work reflected in the Bank's first two fee petitions.

The question of whether "fees on fees" is recoverable in a surcharge action presents a question of first impression in Pennsylvania. Nevertheless, in trust and estate matters, this Court has recognized that fees incurred for services that do not benefit the estate are not properly charged to the estate. *See Estate of Bruner*, 691 A.2d 530, 534 (Pa. Super. Ct. 1997) ("Such services did not benefit the estate, and fees paid as a result are not properly charged to the estate."). It is based on this very same principle that numerous other appellate courts in other states have held that claims for "fees on fees" cannot be recovered in trust and estate matters.

For example, in *In re Estate of Halas*, 512 N.E.2d 1276, 1285 (Ill. Ct. App. 1 Dist. 1987), the Illinois Appellate Court ruled in the context of an estate proceeding that "Time spent preparing or litigating the fee petition does not benefit the estate and will not be allowed." Likewise, in *In re Estate of Inlow*, 735 N.E.2d 240, 254 (Ind. Ct. App. 2000), Indiana's intermediate appellate court ruled that Indiana law "prohibits a probate attorney from seeking fees from the estate or a party for defending the

reasonableness of a fee petition. Again, such a 'service' is a routine cost of doing business and must be factored into an attorney's hourly rate."

Similar rulings have issued from appellate courts in the States of Connecticut, Michigan, and Washington. *See In re Andrews' Appeal from Probate*, 826 A.2d 1267, 1275 (Conn. Ct. App. 2003); *In re Sloan Estate*, 538 N.W.2d 47, 49 (Mich. Ct. App. 1995) ("'Fees for fees' claims are brought in behalf of the attorney seeking the fees and clearly do not benefit the estate because they do not increase or preserve the estate's assets. As the probate court correctly noted, the ordinary fees and costs incurred in establishing and defending a fee petition are inherent in the normal course of doing business as an attorney, and the estate may not be diminished to pay those fees and costs."); *Matter of Estate of Larson*, 694 P.2d 1051, 1053 (Wash. 1985) ("attorneys in probate are not entitled to an additional fee out of the estate in proving the reasonableness of their fees").

In sum, the "fees on fees" that Wachovia Bank sought to collect by means of its second supplemental request for attorneys' fees should be denied because those fees were not incurred for the benefit of the Rosenfeld Trust.

* * * * *

For all of the foregoing reasons, the Orphans' Court's order taxing Wachovia Bank's attorneys' fees and costs incurred in defending against Mrs. Stein's unmeritorious claims against Lester and Robert Rosenfeld should be reversed. At a minimum, a hearing should be held on Wachovia's second supplemental fee petition, and this Court should rule that Wachovia's claim for "fees on fees" is not recoverable.

VIII. CONCLUSION

For the reasons set forth above, appellants Lester Rosenfeld and Robert Rosenfeld respectfully request that this Court reverse the Orphans' Court's Adjudication insofar as it held that the Rosenfelds breached their fiduciary duty to the Rosenfeld Trust and are liable for surcharge. In addition, this Court should also reverse the Orphans' Court's Decrees removing the Rosenfelds as co–trustees of the Rosenfeld Trust and requiring the Rosenfelds to pay the attorneys' fees and costs that Wachovia Bank incurred in defending against Rita Stein's unmeritorious claims against Wachovia.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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